Public Service Commission of Wisconsin
Direct Testimony of Jodee J. Bartels
Gas and Energy Division

Wisconsin Energy Corporation
Docket 9400-YO-100

January 14, 2015

Q. Please state your name, business address, and occupation.

A. My name is Jodee. J. Bartels. My business address is 610 N. Whitney Way, P.O. Box 7854, Madison, Wisconsin 53707. I am employed by the Public Service Commission of Wisconsin (Commission) as an auditor in the Gas and Energy Division.

Q. Please state your educational and background experience.

A. I graduated from the University of Wisconsin-River Falls in 1978, receiving a Bachelor of Science degree with a double major in Accounting and Economics. I have been employed by the Commission since August 1986 as an auditor. I have participated in numerous proceedings involving electric, gas, and water utilities on subjects as varied as revenue requirement, affiliated interest, holding company, industry policy, and merger issues.

Q. What is the purpose of your testimony in this proceeding?

A. The purpose of my testimony is to provide information to the Commission on the acquisition by WEC Energy Corporation (WEC or applicant) of all of the common stock of the Integrys Energy Group, Inc. (Integrys Energy) (Transaction). My testimony will address the Transaction, the resulting holding company structure, transactions costs, transition costs/synergy savings, affiliated interest agreements/transactions (including service company structure), and holding company concerns and requirements.

MERGER TRANSACTION/CORPORATE STRUCTURE

Q. Please briefly explain your understanding of the Transaction and resulting holding company structure.

A. WEC will acquire 100 percent of the outstanding common stock of Integrys Energy.[1] Upon completion of the Transaction the combined company will be called WEC Energy Group (WEC Energy). At the most basic level, this Transaction is the acquisition of a holding company, Integrys Energy Group, Inc. (Integrys Energy)[2] by a holding company, WEC.[3] It is a classic forward triangular merger—at closing the current Integrys Energy holding company will merge with a merger subsidiary that WEC will create and Integrys Energy will be the surviving company. Integrys Energy will then merge into another WEC created merger subsidiary with that subsidiary being the surviving entity. That entity will "stand in the shoes" of Integrys Energy, maintaining all of the current Integrys Energy holding company structure with the exception of Integrys Business Support, LLC (IBS), which will be renamed WEC Business Services LLC (WBS) and become a direct subsidiary of WEC Energy. For convenience and readability, unless context requires

[1] The acquisition price is approximately $9.1 billion, $5.8 billion of which will be for Integrys Energy shares and $3.3 billion for assumed Integrys Energy debt. Integrys Energy shareholders will receive 1.128 WEC shares plus $18.58 in cash for each Integrys Energy share. Total consideration was valued on June 20, 2014 at $71.47 per Integrys share, with a consideration mix of 74 percent stock and 26 percent cash.

[2] Integrys Energy presently owns and operates six regulated natural gas and electric utilities that serve a total 2.1 million customers in Wisconsin, Minnesota, Michigan, and Illinois, plus a service company, Integrys Business Services, Inc. – Integrys Energy has since sold Upper Peninsula Power Company, one of the six regulated utilities. Since the acquisition announcement, Intergrys Energy has sold most of its non-regulated Integrys Energy Services, Inc., retaining only the solar business. Integrys Energy owns Trillium CNG, a non-regulated provider of compressed natural gas fueling services. In 2013, Integrys Energy had total revenues of $5.6 billion, with a net income of $350 million, and employed approximately 5,000 people.

[3] In 2013, WEC had operating revenues of approximately $4.5 billion and net income of approximately $577 million, and employed approximately 4,300 people. WEC's principal subsidiaries are Wisconsin Electric Power Company (WEPCO) and Wisconsin Gas LLC (WG). Through WEPCO and WG, operating as WE Energies, WEC serves approximately 1.1 million electric and 1.1 million gas customers in Wisconsin and Upper Peninsula of Michigan. WEC owns 6,201 MW of electric generating capacity, 45,597 miles of electric distribution lines and 20,967 miles of gas transmission and distribution lines.

otherwise, when I use "merger" or "acquisition" in this direct testimony I am referring to the Transaction.

The post-closing structure of WEC Energy and its first tier subsidiaries would be WEPCO, WG, ATC Holding LLC, WBS, We Power LLC, and Integrys Energy.[4] The current Integrys Energy holding company system will be in the second tier subsidiaries and will consist of Wisconsin Public Service Corporation (WPSC), WPS Investments LLC (WPS), Minnesota Energy Resources Corporation (MERC), Michigan Gas Utilities Corporation (MGU), IES Solar, and Peoples Energy, LLC (Peoples). Peoples is currently a sub-holding company in the Integrys Energy system and will be a sub-sub-holding containing the third tier subsidiaries in the WEC Energy system. Peoples will contain The Peoples Gas Light & Coke Company (Peoples Gas), North Shore Gas Company (North Shore), and Integrys Transportation Fuels, LLC which contains Trillium USA (the CNG business).[5]

Q. Do you have any concerns about the post-closing holding company structure?

A. Yes. Although all utility subsidiaries of WEC and Integrys Energy will remain as subsidiaries of WEC Energy, they will be spread across different layers in the holding company structure. WEPCO and WG will be first tier subsidiaries; WPS, MERC, and MGU will be second tier subsidiaries; and Peoples Gas and North Shore will be third tier subsidiaries. This tends to lead to a more complicated holding company structure and potential inequality among regulated operating companies. The applicant has stated that there are no current plans to change the structure following the proposed transaction.[6] As

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[4] WEC Energy contains other non-regulated subsidiaries (*e.g.*, Wispark, Bostco, Minergy). The total non-regulated portion of the new holding company at the time of closing will be insignificant.
[5] PSC REF#: 213338, Ex.-WEC-Lauber.
[6] Data response PSCW-01.06 PSC REF#: 219011.

currently structured the proposed transaction qualifies as a "reorganization" under Section 368(a)(2)(D) of the Internal Revenue Code, which is generally tax-free to shareholders to the extent of the stock consideration they receive. The applicant expects that the only taxable gain recognized on the transaction will be on behalf of the Integrys Energy shareholders to the extent they receive cash in the exchange.

Q. Why is the applicant proposing this structure?

A. The applicant desires an essentially tax-free reorganization under Section 368(a)(2)(D) of the Internal Revenue Code (Section 368(a)(2)(D)). The applicant states that certain post-transaction restructurings can jeopardize the tax-free treatment. For example, liquidating the surviving merger subsidiaries after the transaction would not allow the applicant to keep the Section 368(a)(2)(D) status.[5]

Q. Please explain your understanding of Section 368(a)(2)(D) of the Internal Revenue Code.

A. From my review of the Internal Revenue Code the surviving merger subsidiary (Integrys Energy) cannot be liquidated without jeopardizing the tax-free treatment. However, it is less clear that some level of reorganization could not occur, so long as assets were not liquidated or control changed. Even then, as long as the merger subsidiary itself remains, it is not clear that entities within that sub-holding company structure could not be liquidated or moved within the corporate structure. Certainly, at and below the Peoples sub-sub-holding level liquidation is possible. In other words, Peoples Gas, North Shore, and Trillium could be liquidated without jeopardizing the tax-free treatment.

Q. Does the Commission need to address holding company structure in this proceeding?

A. No, although the structure is more complicated than necessary, it is not unworkable, at least in the short-term. The potential complications of the current proposed holding company structure will be discussed later in my testimony.

TRANSACTION COSTS

Q. What does the applicant propose regarding transaction costs?

A. WEC has defined transaction costs to include the various costs and fees incurred in connection with the execution of the Transaction (*e.g.*, banker fees, legal fees, etc.). The applicant has estimated transaction costs as follows:

Type of Transaction Cost	Dollars in Millions (000)
Investment Banker	$22,000
Legal	14,400
Legal – Debt Offering	1,500
Regulatory Affairs	1,000
Transfer Agent Fees	1,000
Printers Fees	1,000
SEC Registration	750
Rating Agency Fees	650
Tax and other financial Consulting Work	350
Audit Fees S-4	250
Communications	100
Change in Control	25,500
	$68,500

WEC will account for transaction-related costs in accordance with Generally Accepted Accounting Principles (GAAP). Under GAAP, costs of a business combination are expensed as incurred unless those relating to the issuance of debt or equity securities, which are capitalized. All transaction costs incurred by WEC related to the acquisition of Integrys Energy will be recorded at the parent company, WEC Energy. WEC Energy has committed to not seeking recovery of any transaction costs.

WEC Energy has committed to recording transaction costs at the holding company level. Whether those transaction costs are retained at the holding company level or allocated down to the subsidiaries including public utilities is less clear. If the transaction costs are allocated to the public utilities, they should be posted to public utility below-the-line accounts with no opportunity for rate recovery. Transaction costs should not be considered in determining excess revenues under Wis. Admin. Code § PSC 116.07(6) or any other Commission determination in which earnings is a consideration. All transaction costs incurred by or allocated to WEPCO, WG, and WPSC should be specifically identified and allocated to non-utility accounts.

Q. Please explain why the distinction between *transaction* costs and *transition* costs is important.

A. The distinction has to do with potential cost recovery. The transaction costs, the costs of the actual acquisition of a holding company by a holding company, should not be recoverable from utility ratepayers. With proper application of the statutes and construction of protections in the holding company formation, affiliated interest and security orders, a public utility should be relatively indifferent to the type of corporate structure in which it is "housed."

Q. Does Commission staff agree with the applicant on what constitutes transaction costs?

A. No. There is not a specific definition of what should be included in transition costs. The applicant has included the basic transaction costs. However, the distinction between transaction costs and transition costs is not black and white. Transaction costs are costs related to or directly tied to the act of acquisition. Transition costs are cost related to integrating two completely separate corporate organizations into one. Transition takes place after the act of acquisition. Both transaction and transition costs would not be incurred but for the merger or acquisition. I believe that the applicant's estimate of change-in-control payments is too narrow and the definition of transaction costs does not include directors and officers tail insurance coverage. It is possible to include other costs such as portions of what the applicant has defined as "cash-out" payments and future severance costs.

Q. Please explain your position on change-in-control payments.

A. The applicant has estimated $25,500,000 for change-in-control payments for the one retiring CEO. However, there is information in the Securities and Exchange Commission (SEC) filing that pure change-in-control payments for 12 individuals is $47,604,249.[7] In other data responses and filings the applicant has stated that WEC executive management will hold the executive management positions in the new structure. This implies that the Integrys Energy executive management team will be displaced in its entirety, and thus the higher change-in-control estimate appears more accurate to me.

Q. Are there other payments similar in nature to the change-in-control payments that the applicant did not include in transaction costs?

A. Yes. I would include portions of what the applicant has defined as "cash-out" payments. In response to Commission staff data request (Data Request 18.02, PSC REF#: 226330), the applicant provided details on the discussion of "cash-out" in Direct-WEC-Lauber-18. The applicant's data response states that as of June 30, 2014, WEC estimated that the "cash-out" would be approximately $140,000,000, the amount fluctuating based on the stock price for in stock-based compensation held by Integrys Energy employees and directors.

[7] August 13, 2014 SEC S-4 filing pages 88-100 which details the interest of officers and directors (type of payments). Page 92 lists 12 officers: Schrock, Schott, Borgard, Mikulsky, Radtke, Kallas, Guc, Laakso, Caro, Verbanac, and Morrow.

The data response stated there are four types of equity awards making up the "cash-out" payments: stock option, restricted stock units, performance stock rights, and stock units in deferred compensation plans. If the equity award is a stock option and vests at closing, the payment will be a transaction cost and not recoverable from ratepayers (applicant estimates this cost at $4.5 million). If the equity award is a stock option and vests prior to closing, the payment is part of the purchase price and therefore not recoverable from ratepayers (applicant estimates this cost at$21 million). And, if the equity award is a restricted stock unit or performance stock right that vests prior to closing, it will be treated as a settlement of an existing liability, and if it vests at closing it, will be treated as a transaction cost (applicant did not break these equity award estimates into vested and unvested; restricted stock $36.2 million and performance stock $25.2 million). Stock units in deferred compensation plans will be accounted for as treasury stock (applicant estimates $53.5 million).

Q. Do you have additional comments on change-in-control and "cash-out" payments?

A. Yes. I do not disagree with the applicant's proposed accounting for the different types of equity awards. However, since the dollar amounts and number of employees appropriate to include in either change-in-control or "cash-out" payments cannot be adequately estimated at this time, I believe it is important for the Commission to provide clear guidance on what and who should be included in these categories in any Final Decision in this proceeding. Not doing so could result in ambiguity and potential misunderstandings as to what is (or is not) a transaction cost and therefore unrecoverable from the ratepayers. The broader definition of change-in-control (the $47,604,249) and including the "cash-out" payments that vest at merger closing in my experience is more consistent with actual practice. Since these are evolving items, both in dollars and number of employees, well-specified definitions of “change-in-control” and “cash-out” payments will be necessary for an after-the-fact reconciliation and report to the Commission on the payouts. The Commission’s adoption of the treatment proposed here will provide it with a more accurate picture of the Transaction’s costs.

Q. Please explain your position on directors and officers tail insurance coverage.

A. It is my opinion that directors and officers tail insurance coverage is a transaction cost similar to the change-in-control payments. The Commission confirmed that position in its Final Decision in docket 9405-YI-100, dated February 16, 2007.

Directors and Officers (D&O) insurance is protection against a breach of “duty” by the directors and officers. While there are no standard D&O policies, there are two basic types. A claims-made policy pays based on the date of the lawsuit. An occurrence policy pays based on the date of the accident or occurrence. Claims-made policies only provide protection for lawsuits and actions bought during the policy period (regardless of when the wrongful act may have occurred). Coverage to provide protection for events that take place prior to expiration/cancellation, but for which no claim has yet been filed, is called “tail” insurance. This insurance expense was agreed to in the acquisition agreement and is to provide adequate coverage to these individuals in the event of subsequent litigation to which they could become a party in view of their previous positions with the companies. The acquisition agreement limits the amount related to directors and officers tail insurance to 300 percent annually of the present Integrys Energy policies—currently \$1,865,712 annually or approximately \$5,597,000 annually for six years. The applicant should be required to show that any director or officers tail insurance or equivalent policy is not included in any rate proceeding for any WEC Energy operating utility.

Q. Please summarize your proposed acquistion conditions relating to transaction costs.

A. The Commission should consider the following conditions related to transaction costs:

1. The applicant shall expense the cost to achieve the acquisition as incurred.
2. WEPCO, WG, and WPSC may not recover any acquisition-related transaction costs from the Wisconsin retail jurisdictions.
3. Approximate acquistion-related transaction costs shall include the following amounts:
    - $22 million to investment bankers;
    - $14.4 million legal;
    - $1.5 million legal – debt offering;
    - $1 million regulatory affairs;
    - $1 million transfer agent fees;
    - $1 million printers fees;
    - $ 750,000 SEC Registration;
    - $650,000 rating agency fees;
    - $350,000 tax and other financial consulting work;
    - $250,000 audit fees S-4;
    - $100,000 communications;
    - $47.6 million in pure change-in-control payments;
    - a portion of $140 million “cash-out” payments that vests at closing; and
    - $1.9 million to $5.6 million annually for six years of directors and officers tail insurance or equivalent policy.
4. After closing, and in any rate proceeding decided within six years after the Transaction closing, the applicant shall provide proof that no transaction costs are included in historical expenses of the operating utility or in the determination of revenue requirement.
5. All transaction costs incurred by or allocated to WEPCO, WG, and WPSC shall be specifically identified and allocated to non-utility accounts.
6. Transaction costs shall not be considered in determining excess revenues under Wis. Admin. Code § PSC 116.07(6) or any other Commission determination in which earnings is a consideration.

TRANSITION COSTS

Q. Please comment on transition costs.

A. Transition costs or costs-to-achieve are the costs necessary to integrate two distinct corporate systems into the new combined organization. They are an integral part in the achievement of synergy savings and a successful merger. Transition costs reflect expenditures necessary to effectuate the cost savings from the merger or acquisition through company integration.

Q. What is WEC's position on transition costs or synergy savings?

A. The applicant has repeatedly stated that there have been no studies or estimates of synergy savings or the costs-to-achieve them. It states that there are no plans or studies on integration and that they have no preconceived plans on how the combined company will be operated.[8]

Q. Please comment.

A. It is hard to conceive that no thought has been given to integration. Generally, transition costs or cost-to-achieve integration fall into some basic categories. Separation, retention, relocation, system integration, facilities integration, regulatory process and compliance, and internal/external communications are a few common categories. Some of these categories have elements of both transaction and transition costs. Some of the timing, speed, and complexity of the transition or integration is variable and well within the applicant's control; others are not.

Q. Please comment on the categories of transition costs, starting with categories related to the work force.

[8] Direct-WEC-Reed-34 and 39, ln. 5 (PSC REF#: 213334), and PSC REF# 220187 Data Response No. DGK 1.03 in ICC Docket No. 14-0496.

A. In every merger or acquisition there is some reorganization or elimination of work force. Even though WEC has stated repeatedly that it does not intend to achieve savings through labor reductions, some impact on the work force is inevitable. In any reduction in the work force (elimination of duplicative positions and/or functions), it is necessary to incur cost associated with severance. There is some discretion and control available to the company in this area through the negotiation of severance packages and decisions on timing and source of removed positions. The applicant has taken the positon in the Illinois docket, Ill. Docket No. 14-0496, WEC-Rebuttal-Lauber and Reed, that future severance package and/or early termination costs which may be incurred to create efficiencies and savings would properly be classified as transition costs. This is a gray area where the cost can be either transaction or transition because of the discretion and control available to the applicant. Rather than make a blanket decision on these types of costs, the applicant should be required to provide detailed information in any rate proceeding on each instance of severance and/or early termination—the position, the reasoning, the costs and savings, etc. The Commission can then make an informed decision as to the recoverability—whether the cost is a transaction or transition cost—of the severance or early termination expense on a case-by-case basis.

Q. Please discuss the system integration category of transition costs.

A. Generally, the largest and possibly the most difficult category in which to achieve synergy savings is system integration or consolidation. While there is a potential for significant synergy savings, the costs-to-achieve for those savings will be high. Usually there are significant differences in the technological environments and the backbone applications between the companies. In order to operate efficiently and gain the necessary economies of scale, voice, data and video networks need to be integrated. This can require expansion of very expensive telecommunication capacities. Data centers should be consolidated and other elements of the network scaled to the new company.

Q. Please discuss other potential categories of transition costs.

A. Transition costs are likely to contain relocation costs relating to compensation for moving (house hunting, cost of living differentials, and closing costs); facilities integration costs (restacking, moves, refurbishment, construction, and other leasehold improvements); internal and external communications costs (dissemination of merger information to various stakeholders, information releases, changing signage, etc.); and potential integration costs (travel, support, and consultant costs).

Q. Are your potential transition cost conditions dependent on what the Commission decides on merger savings?

A. Yes. Commission staff witness Christopher Larson summarizes potential alternatives related to merger savings in his direct testimony on pages 3 to 12. Mr. Larson identifies options for the Commission to consider in providing first-year savings to ratepayers, including a bill credit to capture the merger savings for WG, Wisconsin Electric Gas Operations (WEGO), Valley Steam and Milwaukee County Steam. Commission staff witnesses Mr. Larson and Ms. Kettle also identify an option for writing off regulatory deferrals of transmission expenses for WEPCO as detailed in Ms. Kettle's direct testimony. Mr. Larson suggest an option for WPSC where the first year synergy savings could be passed through to customers in a 2016 limited reopener. In the absence of a rate proceeding immediately subsequent to an acquisition, there is no way to capture first-year savings for ratepayers. The options discussed in Commission staff testimony are intended to do that without prejudicing the applicant's ability to recover transition costs in future years.

If the Commission utilizes a bill credit for WG, WEGO, Valley Steam and MC Steam then my proposed transition cost conditions, with the exception of the severance and/or early termination, would apply in any rate proceeding starting in 2017 where merger savings and transition costs is an issue. The same would apply for WEPCO. For WPSC, all of the potential transition conditions that I have proposed would apply, starting with the reopener in 2016 and continuing for any rate proceeding starting in 2017.

Q. What if the Commission declines the options of the bill credit and the write-off of deferred accounts?

A. If the Commission declines to impose conditions that would require bill credits and the write-off of deferred accounts, I would suggest that all of my potential conditions relating to transition costs apply immediately upon the effective date of the Commission's Final Decision in this docket.

Q. Please summarize your potential conditions related to any transition costs.

A. For severance and/or early termination costs the applicant shall provide detailed information in any rate proceeding on each instance of severance and/or early termination—the position, the reasoning, the costs and savings, etc., in sufficient detail for the Commission to make a determination on whether the cost is a transaction cost—unrecoverable or a transition cost.

WEPCO, WG, and WPSC can recover merger-related transition costs from the Wisconsin retail jurisdiction, only if and to the extent such costs are: (a) incurred by or allocated to each of the utilities (each utility's portion or share of merger-related transition costs), (b) associated with financial benefits that each utility's ratepayers will receive as a result of the merger, and (c) the merger-related savings realized by each utility's ratepayers are equal to or greater than its merger-related transition costs. Additionally, it is important that each operating utility be required to identify and track all merger-related transition costs incurred by it and allocated to it in a manner that is readily reviewable and auditable by the Commission at a location within Wisconsin. Further, the utilities, in any proceeding in which recovery, analysis, and/or justification of merger savings is at issue, should provide a detailed analysis of merger costs and savings for Commission review and approval. Such analysis would include: (a) an accounting of merger costs incurred by the combined company broken down by function to the extent possible, (b) a calculation of merger savings accomplished by the combined company broken down by function to the extent possible, and (c) where costs exceed savings for a particular function, a demonstration that the costs are reasonable and prudent.

SYNERGY SAVINGS

Q. Please address the subject of synergy savings.

A. I will address the subject of synergy savings as a general concept and in support of other Commission staff testimony in this proceeding. The applicant has not attempted to identify synergy savings in this proceeding except as a general concept—stating that mergers of this type will generate non-fuel operating and maintenance cost savings in the range of 3 to 5 percent over the long-term (five to ten years).

Generally, one would expect merger savings in the following categories: regulated and corporate staffing, corporate and administrative programs, information technology, supply change, gas supply, fuel procurement, generation dispatch, and system control. Regulated and corporate staffing should involve elimination of corporate and headquarters positions related to redundancies in finance and accounting, human resources, information technology, supply chain, etc. This should also include elimination of non-field, utility back office positions in operating support areas such as asset management, operation planning, customer billing and processing, and other business unit support areas.

Corporate and administrative program savings, should include savings in administrative and general overhead expenses such as postage (non-customer billing), employee travel and education, periodicals, and office supplies related to employee support. These expense reductions are directly tied to staffing eliminations. This area should also include reductions in benefits expense related to consolidations of benefits plan administration and related costs and reduction in cost of the dollar of benefits obtained. Also, credit facilities expense should have the ability to reduce the amount of total credit facilities required for the cash flow or credit support for the combined entity. Directors' fees should be reduced to reflect the elimination of board members from the combined board. The corporate and administrative programs category should also include a reduction in facilities expense related directly to any reductions in workforce. Insurance expense should be reduced related to insurance coverage in the areas of property, directors' and officers' liability and excess casualty related to a potentially reduced risk profile—a broader and more diverse asset base. Professional services expense should be reduced through elimination of non-recurring duplicative services (audit costs, bond issuance letter, pension plan audits, stock issuances, legal expenditures, consulting services, etc.) and increased utilization of a broader skill base. Finally, corporate and administrative programs should include a reduction in shareholder services expense with respect to fixed and variable costs related to annual reporting, annual meeting, proxy fillings, security registration and other investor relations costs.

Information technology savings should occur through the standardization and consolidation of systems applications and hardware. It is not known if WEC and Integrys Energy utilize different systems and vendors for finance, human resources, supply chain, billing and work management applications; however, it is likely. To achieve merger savings and to gain operating efficiencies a single common application should be selected for each of these areas. This will result in termination of current applications that may not be fully depreciated. There should be savings associated with reductions in numbers of data centers, servers, and work stations.

Supply chain savings can be achieved through centralization of purchasing functions (construction, operations and maintenance), volume purchasing, and work package realignment. Gas supply savings could potentially be achieved by combining overlapping asset positions and managing them on a portfolio basis (reducing total storage requirements for the combined entity). On the electric side, there could potentially be savings in fuel procurement, generation dispatch, and system control.

Q. Do you have additional comments on merger savings?

A. Yes. Merger or synergy savings are not really savings so much as a reduction, elimination, or avoidance of an expense. In this transaction, the majority of costs and savings should relate to the corporate or common areas—personnel, information technology, etc. Even in those common areas there are likely distinct differences (system applications, distribution of personnel, and electric versus natural gas) that eliminate or restrict achievement of certain savings. Savings in the information technology area can be difficult to achieve. The potentially many differences in applications and vendors are not conducive to the sharing of knowledge and expertise across the companies. Decisions in this area need to be made on the value of the application itself not the ease or difficulty in exiting an existing contract. Over such a wide spread organization adequate telecommunications capacity for the transfer of data and communication is critical. Decisions made in this area can significantly impact both cost-to-achieve and synergy savings.

In the area of gas supply, there are currently prohibitions on combining the supply portfolios of the public utilities. Gas supply personnel may be shared with the appropriate wavier of the Commission's Natural Gas Standard of Conduct. It is questionable whether a reduction in contracted storage capacity would be permitted by this Commission. I will discuss some of these prohibitions and potential difficulties in optimizing inventory and supply later in my testimony.

Q. Does the Commission need to be concerned about the allocation of potential merger/synergy savings in this proceeding?

A. Probably not. Generally, merger/synergy savings are forecasted and allocated in merger proceedings for one purpose only—to support the transaction by showing the savings exceed the transition costs and costs-to-achieve. Allocation methodology and factors used for that purpose are not permanent in nature; they generally are not offered as appropriate allocation factors to be used in the day-to-day operations of the system. Merger synergy savings are not allocated outside merger proceedings—expenses are.

Often, a disconnect develops between any forecasted merger/synergy savings and any actual reduction in expense. In this proceeding, the applicant only talks about merger/synergy savings and the associated transition costs and cost-to-achieve in general terms. There are no studies or discussion of allocation factors.

Q. What should the Commission consider if the allocation of potential merger savings becomes an issue in this proceeding?

A. It is important that the savings and/or costs-to-achieve be allocated in a manner that ensures jurisdictional integrity, discourages cross-subsidization between gas and electric, mimics to the extent possible the cost causal relationships, and ultimately makes common sense. The applicant has not addressed allocation factors. It has stated that transition costs and savings will be addressed in future rate cases. That does not address the allocation of transition costs and/or savings to the individual operating utilities. While some of the savings and cost will occur at the service company level, it is unrealistic to rely on the service company allocators to handle this area.

Generally, the first level of allocation determines the split between regulated and non-regulated operations. For savings and/or costs-to-achieve that impact only regulated or non-regulated entities, that item should be directed 100 percent to that area. One of the issues at this level is that regulated utility business generally have higher payroll and greater assets that their non-regulated affiliates in the holding company system—so that allocation factors based on payroll and assets will allocate more dollars to the regulated entities. In the WEC Energy system, the small percentage of non-regulated entities somewhat mitigates this concern. The second level should allocate regulated savings and costs-to achieve between electric and natural gas. Again electric utilities are more asset heavy than there gas counterparts—which could result in more costs and savings being allocated to electric if the allocation factor relies heavily on assets. The third level of allocation should split the gas and electric savings and costs-to-achieve between state jurisdictions. Finally, the fourth level should assign the state savings and costs-to-achieve to each jurisdictional utility.

Q. Assuming the allocation of potential savings becomes an issue, are there conditions that the Commission needs to consider in this area?

A. Yes. The Commission should have approval authority over all allocation methodology and factors. If the allocation methodology and factors ultimately approved by the Commission differ from those approved in other jurisdictions the holding company should absorb any cost differentials (the allocation factors may differ from state to state).

Q. Do you have any additional comments on merger savings and the recoverability of transition costs and/or cost-to-achieve?

A. Yes, I do. As stated previously, merger or synergy savings are not really savings so much as a reduction, elimination or avoidance of an expense—costs are allocated but savings are only implicit. The day-to-day expenses will be allocated according to the master services agreements. The allocations in the master service agreements are and will be different from any potential allocation of merger or synergy savings. The affiliated interest allocation methodology will encompass the following principles: first, costs will be directly assigned to the company or function for which the service was performed; second, if the costs cannot be directly assigned (cannot be identified to a specific company but rather were performed for a group of companies or functions) they will be allocated on a cost-causal relationship basis to the companies and/or functions involved using the ratios approved in the master service agreements tailored to the specific subset of companies and/or functions for which the service was provided; and third, if costs are general in nature (cannot be identified with any specific company or function or subset of companies or functions) they will be allocated to all companies and/or functions using ratios approved in the master service agreements.

EXISTING AND PROPOSED AFFILIATED INTEREST AGREEMENTS

Q. What has the applicant proposed for existing and proposed affiliated interest agreements?

A. The applicant states there is an opportunity to consider expanding the services offered by IBS, which is Integrys Energy's current centralized services company. It states that this will eventually result in having IBS—or the renamed WBS—provide common services to WEPCO and WG in addition to the current Integrys Energy utilities. WEC Energy Group will ensure that there is no cross-subsidization between its various regulated and non-regulated subsidiaries. WEC and its current subsidiaries currently share services under a series of Commission-approved affiliated interest agreements. WEPCO has acted in the capacity of a service company for the WEC system. Integrys Energy and its current subsidiaries do the same by having IBS provide a number of shared services to the holding company and all of the Integrys Energy operating companies under two affiliated interest agreements, one for the regulated operating utilities and the second for non-regulated companies. Within the Integrys Energy holding company system, the non-IBS entities may also provide services to each other and to IBS under separate Commission-approved affiliated interest agreements.

The applicant has stated that, at or shortly after closing, IBS will become a direct subsidiary of WEC Energy Group and be renamed WBS. WEC expects that it will eventually have WBS provide an increasing range of services to WEC Energy and the post-acquisition subsidiaries. The applicant states that the transition will be accomplished over time following careful consideration of the areas of the company for which such an arrangement is in customers' best interest. WEC currently anticipates that WBS will provide certain services to WEC Energy and its subsidiaries immediately upon closing, including senior management services, and perhaps legal, accounting, human resources, finance, and potentially other services. Senior management and other appropriate personnel will become employees of WBS immediately after closing. The applicant also states that it may be in the best interests of customers for WEC Energy's subsidiaries to be able to provide services to one another.

Q. How does the applicant propose to accomplish the transition process as it relates to the affiliated interest agreements?

A. The applicant has proposed new affiliated interested agreements in this proceeding, but this Commission has deferred consideration of these agreements in one or more separate dockets rather than including them in its review of the Transaction. Once Commission approval of those agreements is received, WEC and its subsidiaries would have the ability to begin taking services from WBS immediately upon closing, but would not be required to do so. WEC proposes that at or shortly after closing, WEC and its current subsidiaries will each execute affiliated interest agreements based on the Commission-approved Master IBS Regulated Affiliated Interest Agreement and the Master IBS Non-Regulated Affiliated Interest Agreement, as appropriate, except that the WEC will not be required to take services from WBS—allowing for a transition period.

WEC Energy and all its subsidiaries, will also execute an agreement substantially similar to the Commission-approved Integrys Energy Affiliated Interest Agreement, allowing WEC companies to provide services to Integrys Energy companies and Integrys Energy companies to provide services WEC companies—when it is in customers' best interest to do so—all pursuant to appropriate contractual requirements, allocation standards, and compliance process. WBS can take services from the WEC and Integrys Energy companies but not provide them under this agreement.

Q.	Please comment on the applicant's proposal.

A.	Rather than add the WEC companies to the existing Integrys Energy master service agreements with the service company, the applicant has simply used those agreements as a template to create new agreements that are just between the WEC companies and the renamed service company, WBS. This approach was used by the applicant because it believes that this approach allows the WEC companies more flexibility in taking services from WBS. I believe that it adds a layer of unnecessary complexity. In my opinion, the WEC companies could be added to the existing agreements and those agreements modified to allow for a period of time in which the WEC companies could transition to taking services from the centralized service company.

The Commission has declined to consider the proposed affiliated interest agreements as part of this proceeding. As noted above, one or more separate affiliated interest dockets will be opened for the approval of the proposed affiliated interest agreements. However, the structure of the centralized service company and its use is a subject that needs to be addressed in any merger approval in this proceeding. The merger of two distinct holding company systems is much more complicated than simply adding the acquired entities' names to existing affiliated interest agreements or creating separate agreements that bypass the necessary concepts underlying the rationale of a centralized service company within a complex multi-jurisdictional holding company system. I will address some of the considerations that the Commission should consider relating to the proposed agreements in connection with the discussion of the centralized serviced company, WBS.

Q. Are there other affiliated interest agreement issues that need to be addressed?

A. Yes, potentially new affiliated interest agreements may need to be filed for new qualifying relationships. Existing affiliated interest agreements will need to be modified and filed if there are changes to names or services after the merger (this includes, but is not limited to inter-company guarantees and lending arrangements, information sharing, technology and potential gas portfolios).

SERVICE COMPANY

Q. Please comment on centralized service companies.

A. I will provide some background on service companies and then address the issues with the service company in this proceeding. Centralized service companies were structural requirements of the Securities and Exchange Commission (SEC) and the Public Utility Holding Company Act of 1935 (PUHCA or the 1935 Act). The 1935 Act, along with its structural provisions concerning holding company systems has been repealed and replaced with the Energy Policy Act of 2005 (EPACT 2005), which is basically an access to books and records act. The SEC has been replaced by the Federal Energy Regulatory Commission (FERC) as the oversight agency. The importance of the service company concept remains critical in the structuring of holding company systems. The SEC believed that service companies were important to capturing economies of scale and scope. I would add that a separate and distinct service company adds structure and clarity to the provision of services among the entities in a holding company system. FERC, under EPACT 2005, has assumed jurisdiction over service company reporting (federal), system of accounts, and selective review and approval of service company allocations. There is no federal oversight or authority over the structural provisions of the service company. It is my opinion that a separate and distinct service company, its structure, and associated master service agreements are proper conditions of merger approval.[9] It is important that the Commission, in any approval in this proceeding and in its subsequent affiliated interest approval of service company agreements, apply structural conditions to the service company. It is also critical that the Commission address the issue of federal preemption regarding service company allocations.

Service companies should only be involved in the provision of general administrative goods and services where there is a clear demonstration of economies of scale and scope. The SEC believed that all entities in the holding company system should be required to take goods and services from the service company regardless of whether or not the entity could have either acquired or provided the good or service at a lower cost on its own. This Commission has previously determined that a utility in the above situation has a right and a duty to refuse service from the service company. The

[9] The only place for the Commission to require service company formation and structural conditions is as a condition of merger approval. The holding company can voluntarily form a service company. Outside of a merger order the only other option open for the Commission on its own motion would be rejection or denial of affiliated interest approval to cost allocation agreements that did not utilize a service company or one structured appropriately and non-recovery of costs in rate proceedings.

discrepancy arose because the SEC was in the business of optimizing the holding company system while the Commission desired lower utility costs.

Service companies provide goods and services to both regulated and non-regulated subsidiaries in the holding company system and as such could provide a conduit for the transfer of confidential or market sensitive information. It is necessary that the Commission not only mandate compliance with the appropriate standards of conduct (both federal and state) but also condition its merger and affiliated interest agreements on this basic premise.

Service companies are created to capture economies not to become profit centers. Therefore, while it is appropriate that the service company earn a return on its investment—that return should be no greater than the regulatory return provided its utility affiliate, not based on what the market will bear. In the same vein, provision of goods and services by the service company to third parties (non-related entities) should be limited, with any earnings above cost, used to offset the billings of member companies.

Additional structural conditions pertaining to service companies relate to access to the books and records of the service company, nondiscriminatory provisions, and provisions that address cross-subsidization.

Q. Please comment on the service company in the proposed WEC Energy holding company system.

A. IBS is an existing centralized service company in the Integrys Energy holding company system. The Commission in its merger approval in docket 9405-YI-100 mandated the formation of a centralized service company. Commission approval of that formation took place in docket 5-UI-111 and was the product of a settlement process with all of the implied compromises associated with that type of process. The applicant in this proceeding proposes to simply rename IBS and make it a direct subsidiary of WEC Energy. That action takes a centralized service company that was specifically created for a unique holding company system and assumes that it can function unchanged in a new more complex holding company structure without modification. I am not sure that is practical or possible. As the applicant has repeatedly stated, there have been no studies on the integration of the two holding company systems; nor is there currently a plan of integration. It has stated that any integration, combination, and/or modification will occur over a period of years. That means that for the holding company system, its subsidiaries, and especially the centralized service company, the associated affiliated interest agreements are in a high degree of flux.

Q. How does the fluid situation you describe respecting the service company and affiliated interest transactions/agreements affect the Commission's approval here?

A. It is my opinion that Commission approval should be based on the facts that are known at this time and what the Commission expects of these structures, entities, and agreements. The Commission should, as a condition of merger approval, take continuing jurisdiction over the service company structure as it has in past merger approvals involving centralized service companies. This will allow the Commission input and, ultimately, veto power over the evolving service company in addition to its affiliated interest jurisdiction. Although, the service company is shown on organizational charts as a non-regulated affiliate, it is in reality an extension of the utility and in my opinion should be treated as such. The service company provides functions previously provided by the utility, with the centralized nature allowing it to capture economies of scale and scope across the holding company system. However, a service company should not be used as a tool to permit the movement or allocation of costs to advantage one jurisdiction or entity over another.

It has become clear from my decades of working with holding company systems, service companies, and the associated affiliated interest agreements that certain requirements or standards of conduct have become necessary. The Commission has tried to circumvent some issues by requiring separate affiliated interest agreements for the regulated and non-regulated entities and the service company. As it is the same service company personnel and assets providing the services to both sets of entities, I am no longer confident that separate agreements are sufficient in and of themselves. I believe that standards of conduct are needed not only between regulated and non-regulated subsidiaries, but between regulated subsidiaries – particularly within a complex multi-jurisdictional environment. Rather than develop those standard in this docket, the Commission can direct their development and inclusion in the approval of the master service agreements between the entities and the service company.

The affiliated interest investigation of IBS in Illinois raises other concerns involving non-regulated activities and entities. The Commission should monitor those proceedings and take whatever actions necessary, including limiting the non-regulated entities access to the service company. It also points out the need for education of service company personnel on the regulatory restrictions and appropriate affiliated interest interaction. Again, these issues can be addressed in the affiliated interest approval of the master service agreements between the entities and the service company.

In order to fully address these concerns, it may be necessary to give interim affiliated interest approval to the master service agreements so that something is in place at merger closing that allows the necessary interactions between the entities in the holding company system post-merger.

Federal Preemption – Service Company

Q. Please address the risk of federal preemption and service companies.

A. Under EPACT 2005, there is an opportunity for federal preemption related to the service company allocations. Section 1275 of the EPACT 2005, allows a holding company system to apply to FERC for review and approval of its service company allocations. This creates a situation similar to the one that existed between the SEC, FERC, and state commissions known as the *Ohio Power* decision.[10] In that decision, the court held that the SEC could approve cost allocations that differed from those established by FERC and the states, resulting in trapped costs. The repeal of the 1935 Act eliminated the trap between the SEC and FERC. But with Section 1275, that situation could exist between the states and FERC. To prevent this situation, WEC should be required to obtain approval from state commissions before applying to FERC.

Q. Are there further conditions the Commission should consider regarding WBS and the master service agreements?

A. Yes. The Commission should consider conditioning its merger approval on having an independent audit of the service company and its transactions within two years after closing, and thereafter every three years. The Commission would select the auditor and have full control over the audit work (scope, supervision, etc.) with the audit product

[10] *Ohio Power v. FERC*, 954 F.2d 779 (D.C. Cir. 1992).

being a Commission product. WEC Energy would be required to provide the Commission a list of all external audit firms the holding company system has contracts with, and would be billed for the audit cost. The cost of the audit would be kept at the holding company level.

Q. Please summarize your proposed service company conditions.

A. If the Commission determines to approve the acquisition, the conditions proposed here with respect to the service company will clarify and preserve the Commission's structural jurisdiction over the service company. The service company shall be limited to performing services where there are efficiencies and economies of scale that could not be achieved if the services were not performed by the service company. If, in the future, WEC Energy and/or any of its subsidiaries are down-sized in any significant way, the absolute cost allocation to WEPCO, WG, and WPSC shall not increase unless the utilities demonstrate that the cost allocation is just and reasonable. In its performance of services, the service company (a) shall follow applicable federal and state regulation, including codes and standards of conduct; (b) shall not give one or more entities in the corporate structure a competitive advantage in relevant markets; (c) shall not subsidize WEPCO, WG, and/or WPSC or cause WEPCO, WG, and/or WPSC to subsidize an affiliate; and (d) may include a return on its net assets at a rate no higher than the prevailing weighted cost of capital for WEPCO,WG, and/or WPSC. The service company may not provide services to companies that are not part of the holding company system without the Commission's approval. The service company may temporarily provide transition services to an entity that is transferred to a third party. The service company shall apply any earnings as a deduction to the amounts reimbursable by its associated affiliates.

The parent holding company or its subsidiaries shall not elect to have the FERC review pursuant to Section 1275 of EPACT 2005, 42 U.S.C. § 16462, the allocation of costs for goods and services provided by the service company, until the Commission has reviewed and taken action on the affiliated interest transactions and agreements associated with the service company of amendments thereto. If the Commission has not completed its review and approval within a reasonable time after the Commission determined an amendment to the service company agreement is complete, the entities may seek such FERC review after giving the Commission 60 days' prior written notice.

The Commission shall have full access to the books and records of the service company as provided in Wis. Stat. §§ 196.52 and 196.795(5).

WISCONSIN UTILITY HOLDING COMPANY ACT

Q. Please provide general background on the Wisconsin Utility Holding Company Act (WUHC).

A. My understanding of the events surrounding the discussion and enactment of the WUHC is based on review and study of various articles and papers from the time period surrounding the enactment of the statute.[11] In the early 1980s, the utility industry was in a period of change brought about by a softening demand for energy. The economy was characterized by slow growth, skyrocketing construction costs, increased cost for providing energy, and the push for energy conservation. A number of public utilities

[11] National Association of Regulatory Utility Commissioners (NARUC) committee reports on non-utility investment or diversification (there were three committees 1971-1972, 1981-1982, and 1988); Former Commissioner Stanley York's binder on diversification (Chairman York – was head of the 1981-1982 NARUC committee on diversification; Report and Recommendations, Investigation of Utility Diversification and Holding Company Formation Activities prepared for the Public Service Commission of Wisconsin by Lubow, McKay, Stevens & Lewis, April 1985; Diversification in the Utility Industry Final Report, 1982, by Cabot Consulting Group; Issues Related to Utility Diversification and Holding Companies, Informational Bulletin 85-IB-1, October 1985 by the state of Wisconsin Legislative Reference Bureau; as well as many articles including Energy Utility Diversification: Its Status in Wisconsin by J. Robert Malko and George Edgar published in Public Utilities Fortnightly August 7, 1986.

looked to diversification as a way to improve their financial status and attract new capital. In Wisconsin, the public utilities were in good financial condition, having avoided excess generating capacity, construction cost overruns, and project cancellations. However, Wisconsin utilities found themselves in the position of having excess equity (lack of the need to invest in new utility construction led to accumulating earnings that added to stockholders equity). The increased equity adversely affected the debt/equity rations of the utilities. There were several options available for balancing the ratio of debt to equity, including placing money aside for future construction or expenses (*e.g.* pollution control, acid rain, decommissioning), paying higher dividends to stockholders or repurchasing stock, or investing in new businesses (diversification). Only diversification into new business both reduced equity and provided the potential for growth. Wisconsin utilities chose diversification arguing that it would benefit the state through the infusion of investment capital and the creation of new jobs. The diversification issue was framed as one of defining limits for non-utility investment such as the amount of investment, the type of businesses, and the degree of control to which the non-utility investments would be subject. This led to the enactment of the WUHC Act, 1985 Wis. Act 79, in November 28, 1985.

Wisconsin Stat. § 196.795, the WUHC Act, gave the Commission more direct control over the holding company. The statute is very much one of structural regulation. The statute allows the Commission to exercise control over the very formation of a holding company and control over the ownership of a holding company by means of the percentage ownership provision as well as the takeover section. The statute also gives the Commission control over the makeup of the holding company system (asset cap limitation on non-utility investments, requirements as to the type of investment, location (in-state), etc.). Finally, the statute provides the Commission the ultimate tool to protect the public interest—the ability to require divestiture of the public utility.

Wisconsin Stat. § 196.795(6)(m), commonly referred to as the asset cap, was part of the original WUHC Act. Wisconsin Stat. § 196.795(6)(m) limited the non-utility assets of a public holding company to 25 percent of the public utility assets engaged in the generation, transmission or distribution of electric power (commonly referred to as the electric utility assets) plus a percentage, as determined by the Commission, which may be more, but not less, than 25 percent of the non-electric utility assets (gas, water, and steam). Given the articles and publications of that time, I believe that it is clear that the asset cap was an attempt to maintain a simple holding company structure that ensured utility predominance and effective state regulation. The investments in non-utility assets were limited so that any associated risk would also be limited.

1999 Wisconsin Act 9 (the 1999-2001 Biennial Budget Act or Act 9), effective October 29, 1999, contained provisions relating to public utility holding companies, electric power transmission, public benefits, and other aspects of electric utility regulation and is commonly referred to as the "Reliability 2000" legislation. Act 9 provided a public utility holding company with partial relief from the limits on non-utility assets (the asset cap); that it may own, if the electric utilities in the holding company took certain prescribed actions with respect to their electric transmission facilities. The partial asset cap relief was accomplished in the following ways. Act 9 created a new classification of assets called "eligible assets". Eligible assets of a non-utility affiliate in a holding company system are excluded from both the sum of the assets of the public utility affiliate and of the non-utility affiliates in the asset cap formula. In other words, eligible assets are excluded from the numerator and the denominator. Eligible assets are assets of any non-utility affiliate that is used for any of the following:

- producing, generating, transferring, delivering, selling or furnishing gas, oil, electricity or steam energy;
- providing an energy management, conservation or efficiency product or service or a demand-side management product or service;
- providing an energy customer service, including metering or billing;
- recovering or producing energy from waste materials;
- processing waste materials;
- manufacturing, distributing or selling products for filtration, pumping water or other fluids, processing or heating water, handling fluids or other related activities;
- providing a telecommunication service;
- providing an environmental engineering service.

The preceding list encompassed the majority of the assets of the non-utility affiliates of the four major holding companies at the time the law was enacted. The effect on the asset cap formula is to remove any asset cap-based restriction on the holding company investments in eligible assets. Act 9 also allowed the net book value of the transmission facility assets that the public utility transferred in compliance with Act 9, to be included in the sum of the assets of the public utility affiliate in the asset cap formula as if the public utility still owned them. Act 9 provided the same provision for any future requirement for transfer of generation assets.

The asset cap, prior to Act 9, limited the size of the non-utility investments, thereby limiting the volume of affiliated interest transactions as well as the complexity of those transactions. It is my opinion that the changes Act 9 made to the asset cap lessened regulatory flexibility. The creation of eligible assets effectively allowed the potential for unlimited non-utility investment in those lines of business. Utility predominance in a holding company structure is no longer a given. This means that the other statutes take on more importance. Potential risk from the non-utility investments can no longer be controlled by controlling the size of those investments. Regulation of securities issuances, dividend policy and affiliated interest transactions and relationships becomes more important in order to protect ratepayers with the relaxation of the asset cap.

The argument has been made in various merger dockets that certain statutory provisions related to non-utility investments and holding companies are unnecessary. Under this view the Commission's ability to regulate the public utility portion of the holding structure was sufficient to provide effective state regulation. However, regulation of the non-utility investments through regulation of the public utility affiliate can only be effective if the public utility can be effectively isolated from the non-utility activities, and this may not be possible. There are several examples where state regulation has not been sufficient to prevent non-utility business failures from adversely affecting the financial viability and credit standing of the holding company systems.[12]

In the case of WEC Energy, a multi-state holding company, the protection provided by Wisconsin regulation of Wisconsin public utilities are limited. The Commission regulates only three of the utilities in the WEC Energy holding company system. The level of the non-utility investments is based on the assets of all utilities. This potential problem is minimized initially by the small level of non-regulated

[12] Pinnacle West Capital Corporation (PWCC) and Merabank; Pacific Enterprises and Thrifty Corporation; FPL Group and Colonial Penn Group; Tuscon Electric Poser; Hawaiian Electric Industries, Inc. Written statement of John P. Hughs, Director of Technical Affairs, The Electric Consumers Resource Council (ELCON) at a June 6, 1996, U.S. Senate hearing on the PUHCA.

investment. The current level of non-regulated investment is not an indicator of future levels. Management strategies change over time and as new opportunities develop.

HOLDING COMPANY PRINCIPLES

Q. Please discuss holding company principles.

A. The Commission is guided by the following principles, which were incorporated by the Legislature in the act which created the holding company statute:

- utility ratepayers shall not be made worse off in any way by the formation and operations of the holding company.
- utility ratepayers should benefit from the activities of the holding company, at least indirectly, as taxpayers and community members.
- non-utility operations of the holding company or its non-utility subsidiaries should not be regulated.
- the formation and operation of the holding company shall in no way diminish the Commission's authority over the utility.

Wisconsin Stat. § 196.795(2)(e) specifically provides that the Commission may impose terms, limitations or conditions which are consistent with and necessary to satisfy the terms of Wis. Stat. § 196.795(5)(b) to (s), at the time of approval of the formation of a holding company. Wisconsin Stat. § 196.795(2)(f) specifically provides that at any time subsequent to the time the Commission approves the formation of a holding company under paragraph (e), the Commission may modify any "term, limitation or condition imposed under paragraph (e) or add any limitation, term or condition under (e) which is consistent with and necessary to satisfy the terms of Wis. Stat. § 196.795(5)(b) to (s).

HOLDING COMPANY CONDITIONS

Q. Please address the area of holding company requirements.

A. Each holding company is unique and the conditions applied to it should be tailored to fit its system. That also means as the system changes so should the conditions that are necessary and appropriate. WEC Energy is neither WEC nor Integrys Energy; the system will change with this acquisition and so will its risk profile. Conditions should be tailored to this reconfigured organization. It is my opinion that it was for this very purpose that Wis. Stat. § 196,795(2)(f) was constructed.

The following initial holding company conditions are necessary:

1) WEC Energy shall be subject to all applicable requirements of Wis. Stat. § 196.795 and to all of the conditions and requirements in any Commission order related to WEC and Integrys Energy, including but not limited to the holding company formation orders and relevant merger orders.

2) All books and records of all entities in the corporate structure shall be readily available for Commission staff review in a reasonable manner, subject to approval by the Commission.

3) The Commission shall receive prompt notice of any filing by any of the holding company or its subsidiaries with other state commissions and FERC that is relevant to the Commission's authority and obligations.

Other conditions including financial conditions are discussed in other Commission staff witnesses' testimony in this proceeding.

It is necessary for the Commission to condition holding company formations or major reorganizations of holding company systems so Commission regulation of those systems is effective and proactive. Not addressing these issues up front could put the Commission in a difficult situation later. Rather than preventing situations that create risk to the public utility, the Commission would be put in a position of reacting to them on an after-the-fact basis. After the fact prudence reviews, disallowances, and required divestitures[13] impose added risk to all parties.

[13] Wisconsin Stat. § 196.795 allows the Commission to require divestiture of the utility should the non-utility investments significantly and detrimentally affect the utility; this could be used as a preventative remedy should conditions or circumstances warrant.

The Commission could face the risk that the damage done to the utility is irreversible. Approving a merger without adequate conditions to safeguard the utility could eventually require divestiture of the utility which benefits no one and would significantly impact all parties.

Pulling a public utility out of a failing or financial distressed holding company system has the potential to further damage that system, its investors, bondholders, and creditors. The public utility would likely be distressed, potentially bankrupt, and needing to reconstitute itself. Ratepayers would be subject to higher capital and debt costs and potentially required to rebuild utility systems and controls that they had already paid for.

I believe that none of the conditions proposed are excessive, and in fact, some are merely reinstatements or refinements of existing conditions. They provide clarity, tailor the conditions to the reconfigured holding company system, and ensure Commission jurisdiction in protection of the public utility and public interest.

Q. Does that conclude your direct testimony?

A. Yes, it does.

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